

## Message Text

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ACTION ARA-15

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TO SECSTATE WASHDC 8869

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EO 11652: N/A  
TAGS: EGEN, EFIN, PN  
SUBJECT: PANAMA FACES INCREASING PUBLIC DEBT PROBLEM  
REF: PANAMA 03815

1. SUMMARY: THERE WAS SCATTERED EVIDENCE IN 1978  
SECOND QUARTER ECONOMIC INDICATORS OF THE EXPECTED  
POST-TREATY RATIFICATION UPTURN IN THE PANAMANIAN  
ECONOMY, ALTHOUGH OVERALL ACTIVITY WAS STILL TRENDLESS  
AT ROUGHLY THE YEAR AGO LEVEL. A BACKLOG OF DEFERRED  
INVESTOR AND CONSUMER SPENDING, PLUS THE GENERAL  
EUPHORIA OVER TREATY RATIFICATION, MAKES AN ACCELERATING  
ECONOMIC PACE OVER THE NEXT YEAR OR TWO APPEAR FAIRLY  
INEVITABLE. THE GAINS WILL BE SHORT TERM, HOWEVER,  
AND SHOULD HAVE LITTLE BEARING ON PANAMA'S 5-10 YEAR  
ECONOMIC OUTLOOK. THIS WILL HINGE PRINCIPALLY ON PRIVATE  
INVESTOR RESPONSE TO EVIDENCE ON SUCH PRESENTLY  
UNANSWERED QUESTION AS THE GOVERNMENT'S POLITICAL DRIFT,  
FUTURE POLICY TOWARD BUSINESS, GOP HANDLING OF NEW  
RESOURCES AND RESPONSIBILITIES UNDER THE NEW TREATIES,  
AND THE MANAGEMENT OF ITS INCREASINGLY BURDENSOME PUBLIC  
DEBT. THUS, NO MEANINGFUL MEDIUM TERM PROJECTION IS  
POSSIBLE UNTIL SUCH EVIDENCE BEGINS TO APPEAR, ROUGHLY,  
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ONE TO TWO YEARS FROM NOW. END SUMMARY.

2. RATIFICATION OF THE NEW CANAL TREATIES REMOVED A  
MAJOR OBSTACLE TO AN UPTURN IN THE PANAMANIAN ECONOMY.  
A RISING TEMPO OF ECONOMIC ACTIVITY CAN BE EXPECTED;  
IN FACT, THE LATEST ECONOMIC INDICATORS COVERING THE  
1978 FIRST HALF PROVIDED SCATTERED EVIDENCE THAT AN

UPTURN IS GETTING UNDERWAY. HOWEVER, BOTH THE FIRST AND SECOND QUARTERS SHOWED ONLY MODERATE SEASONAL CHANGES WITH NO APPARENT TREND OR SIGNIFICANT CHANGE IN OVERALL ECONOMIC ACTIVITY FROM THE YEAR EARLIER LEVEL.

3. TOTAL MANUFACTURING IN THE SECOND QUARTER WAS OFF SLIGHTLY FROM THE FIRST QUARTER BECAUSE OF A SEASONAL DECLINE IN SUGAR REFINING AND WAS SIX PERCENT BELOW THE 1977 SECOND QUARTER LARGELY FROM REDUCED PETROLEUM REFINING. SECOND QUARTER CONSTRUCTION PERMITS DECLINED SLIGHTLY FROM THE FIRST QUARTER, BUT WERE STILL ROUGHLY FIFTY PERCENT ABOVE THE EXTREMELY DEPRESSED LEVEL OF A YEAR AGO. FIRST HALF IMPORTS (EXCLUDING PETROLEUM) WERE 22 PERCENT HIGHER THAN IN 1977, WHILE THE EXPORT TOTAL (EXCLUDING PETROLEUM) WAS ESSENTIALLY UNCHANGED. BANANA EXPORTS REMAINED SLIGHTLY AHEAD OF LAST YEAR, BUT BOTH SHRIMP AND SUGAR EXPORTS WERE DOWN. PETROLEUM (CRUDE) IMPORTS, REFINING ACTIVITIES, AND PRODUCT EXPORTS ALL WERE BELOW THEIR CORRESPONDING FIRST AND SECOND QUARTER LEVELS OF A YEAR AGO. THE GENERAL PACE OF ACTIVITY IN THE COLON FREE ZONE PICKED UP SIGNIFICANTLY DURING THE SECOND QUARTER, WITH INCREASED IMPORTS AND RE-EXPORTS RESULTING IN RISING LEVELS OF BOTH EMPLOYMENT AND EARNINGS. ALSO, UNEMPLOYMENT IN THE METROPOLITAN LIMITED OFFICIAL USE

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REGION WAS DOWN TO 7.6 PERCENT ACCORDING TO THE GOP'S MARCH 1978 SURVEY, COMPARED TO 11.6 PERCENT IN MARCH 1977, ALTHOUGH THE GOP'S EMERGENCY EMPLOYMENT PROGRAM OF THE PAST NINE MONTHS ACCOUNTED FOR AT LEAST PART OF THE DECLINE. CHANGES IN PANAMA'S PRICE LEVEL HAVE BEEN MODERATE SO FAR THIS YEAR -- THE CONSUMER AND WHOLESALE PRICE INDEXES FOR THE FIRST HALF WERE HIGHER BY ONLY 3.4 AND 4.2 PERCENT RESPECTIVELY THAN THEIR CORRESPONDING 1977 LEVELS.

4. THE INCREASED ECONOMIC PACE IN PANAMA WHICH WE FORESEE AS A RESULT OF THE TREATY RATIFICATION SHOULD BE CLEARLY IN EVIDENCE IN 1978 SECOND HALF ECONOMIC STATISTICS. ALTHOUGH PART OF THE INDICATED UPTURN STEMS FROM PSYCHOLOGICAL FACTORS, THE PRINCIPAL REASON FOR EXPECTING A PICKUP IS THE 12 MONTHS' OR MORE BACKLOG OF DEFERRED SPENDING WHICH PRECEDED TREATY RATIFICATION, WHEN BOTH THE BUSINESS COMMUNITY AND CONSUMING PUBLIC WERE CURBING OUTLAYS WHILE AWAITING THE TREATY OUTCOME, THEREBY EXTENDING PANAMA'S RECESSION. THIS BACKLOG INCLUDES MODEST

SCALE CONSTRUCTION OF ALL TYPES (POSSIBLY A FEW MAJOR PRIVATE SECTOR INITIATIVES), A VARIETY OF OTHER SMALL INVESTMENT ACTIVITIES (E.G., NEW EQUIPMENT, MODERNIZATION), AND CONSUMER DEMAND FOR BOTH DOMESTICALLY PRODUCED AND IMPORTED PRODUCTS. GENERAL TORRIJOS' RECENT LOWERING OF AUTO TAXES BY FIFTY PERCENT, AND -- MORE IMPORTANTLY -- HIS DECLARED INTENT TO RAISE WAGES IN THE PUBLIC SECTOR AND TO URGE AN INCREASE ONTO THE PRIVATE SECTOR AS WELL SHOULD FURTHER STRENGTHEN CONSUMER DEMAND.

5. THE GOP'S FIRST HALF BUDGET PERFORMANCE IS ALSO

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A POSITIVE FACTOR, ON BALANCE, IN THE SHORT-TERM OUTLOOK. REVENUES WERE 14 PERCENT AHEAD OF LAST YEAR (PLUS NINE PERCENT BUDGETED FOR ENTIRE 1978) WITH THE BULK OF THE INCREASE COMING FROM THE FIVE PERCENT CONSUMER TAX AND A LESSER AMOUNT FROM INCREASED IMPORT TAX COLLECTIONS. THIS PERMITTED A SEVENTEEN PERCENT INCREASE IN CURRENT OPERATING OUTLAYS OVER THE 1977 FIRST HALF (PLUS 4.3 PERCENT BUDGETED FOR ENTIRE 1978). HOWEVER, SUBSTANTIALLY HIGHER INTEREST COSTS AND TRANSFER PAYMENTS (MOSTLY TO AUTONOMOUS AGENCIES, POSSIBLY OTHER UNSPECIFIED PURPOSES) ABSORBED MUCH OF THE REVENUE GAIN SO THAT FIRST HALF OPERATING EXPENDITURES OF THE MINISTRIES WERE ONLY 6.8 PERCENT ABOVE THE 1977 FIRST HALF (4.7 PERCENT INCREASE BUDGETED FOR THE YEAR). THESE REVENUE AND OPERATING EXPENDITURE INCREASES RESULTED IN A CURRENT ACCOUNT SURPLUS OF ONLY 2.8 MILLION DOLLARS

BY JUNE 30 COMPARED TO 17 MILLION DOLLARS BUDGETED FOR THE YEAR. THE INTENSE FIRST HALF PRESSURE TO INCREASE ORDINARY BUDGET OUTLAYS ARE LIKELY TO PERSIST IN VIEW OF CURRENT POLITICAL STIRRINGS, AS ALREADY MANIFESTED IN TORRIJOS' PUBLIC PROMISE OF HIGHER PUBLIC SECTOR WAGES. THIS IS ALSO LIMITED OFFICIAL USE

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REFLECTED IN RECENT PRESS ITEMS, ATTRIBUTED TO MINISTRY OF PLANNING SOURCES, INDICATING THAT NEXT YEAR'S ORDINARY BUDGET WOULD PROBABLY BE ABOUT ELEVEN PERCENT HIGHER THAN IN 1978. ALTHOUGH DATA ON THIS YEAR'S PUBLIC SECTOR INVESTMENT OUTLAYS ARE NOT AVAILABLE, THE EXTREMELY HIGH RATE OF PUBLIC SECTOR BORROWING DURING THE FIRST SIX MONTHS OF 1978 SUGGESTS THAT THE GOVERNMENT'S INVESTMENT PROGRAM FOR THIS YEAR IS AT LEAST UP TO TARGET.

6. THE FOREGOING FACTORS INDICATE THAT THE EXPECTED 1978 SECOND HALF INCREASE IN ECONOMIC ACTIVITY IN PANAMA SHOULD BE BOTH RAPID AND QUITE GENERAL. THIS, COUPLED WITH ESSENTIALLY ZERO OVERALL CHANGE DURING THE FIRST HALF SUGGESTS THAT TOTAL REAL GDP GROWTH FOR THE YEAR WILL AMOUNT TO AROUND THREE PERCENT. THE TREND SHOULD CONTINUE THROUGH 1979 AND ON INTO 1980, AT ROUGHLY A SIX PERCENT ANNUAL GROWTH RATE, SINCE BASICALLY THE SAME FACTORS WOULD CONTINUE TO BE THE PRIMARY DETERMINANTS. MOREOVER, FURTHER BOLSTERING OF PUBLIC SECTOR SPENDING IS LIKELY TO TAKE PLACE IN THE EARLY MONTHS OF CANAL COMMISSION PAYMENTS TO THE GOP UNDER THE NEW TREATY. ON THE OTHER HAND, CAPACITY LIMITATIONS AND MATERIALS SHORTAGES ALONG WITH OTHER POSSIBLE RESTRAINTS SUCH AS POLITICAL UNREST, COULD HAVE SOME DAMPENING EFFECT.

7. THE NEAR CERTAINTY OF THIS INITIAL POST-TREATY ECONOMIC RESURGENCE STEMS BASICALLY FROM FAIRLY OBVIOUS SHORT-TERM FORCES THAT ARE ALREADY AT WORK, AS DESCRIBED ABOVE. ITS PRECISE PACE AND DURATION ARE LESS CERTAIN. MORE IMPORTANTLY, HOWEVER, THE LONGER RUN FACTORS WHICH WILL LARGELY DETERMINE THE LIMITED OFFICIAL USE

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COURSE OF ECONOMIC DEVELOPMENTS HERE OVER THE NEXT FIVE TO TEN YEARS WILL HAVE HAD LITTLE, IF ANYTHING, TO DO WITH THIS INITIAL RECOVERY. IN OTHER WORDS,

WHAT HAPPENS TO THE PANAMANIAN ECONOMY STATISTICALLY  
OVER THE NEXT COUPLE OF YEARS WILL PROVIDE LITTLE  
INDICATION OF WHERE IT IS HEADING. THE REAL CLUES  
TO PANAMA'S ECONOMIC FUTURE WILL INVOLVE MORE BASIC  
CONSIDERATIONS, WHICH MAY NOT BE EASY TO DISCERN  
OR MEASURE WITH ANY PRECISION.

8. A CENTRAL ISSUE IS THE ATTITUDE OF THE PRIVATE  
BUSINESS COMMUNITY. PANAMA'S ECONOMIC FUTURE STILL  
HINGES ON A STRONG, VIGOROUS AND EXPANDING PRIVATE  
SECTOR, CONCENTRATED LARGELY IN THE TRADE AND SERVICE  
SECTORS, AS WAS THE CASE WITH PAST PROGRESS. GOP TAKE-  
OVER AND OPERATION OF NEWLY TRANSFERRED CANAL  
COMPANY ASSETS, PLUS ANY OTHER GOVERNMENT INITIATIVES  
INVOLVING SUBSTANTIAL INVESTMENT, CANNOT BEGIN TO  
SUBSTITUTE FOR THE TRADITIONAL PRIVATE SECTOR ROLE  
IN PANAMA. PANAMA'S MEDIOCRE ECONOMIC PERFORMANCE OF  
THE PAST THREE YEARS IN THE PRESENCE OF MASSIVE  
INCREASES IN PUBLIC SECTOR INVESTMENT AMPLY  
DEMONSTRATES THAT. AND MUCH OF THE PANAMANIAN  
BUSINESS COMMUNITY STILL SEEMS TO HAVE RESERVATIONS  
OVER PANAMA'S LONGER RUN ECONOMIC OUTLOOK BECAUSE  
OF SOME FUNDAMENTAL UNCERTAINTIES WHICH THEY FEEL  
EXIST IN BOTH THE POLITICAL AS WELL AS ECONOMIC  
ARENAS. CONSEQUENTLY, COMMITMENTS IN PANAMA BY  
PRIVATE INVESTORS BOTH HERE AND ABROAD ARE NOT LIKELY  
TO BE MADE ON A SIGNIFICANT SCALE NOR REAL  
INTENTIONS MADE KNOWN SO LONG AS SUCH UNCERTAINTIES  
EXIST.

9. MANY POTENTIAL INVESTORS FEAR THAT THE NEWLY

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FM AMEMBASSY PANAMA  
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PERMITTED POLITICAL FREEDOM COULD LEAD TO DESTABILIZING CONFLICT. ALSO, THERE IS STILL UNEASINESS OVER GOP POLICY TOWARD THE PRIVATE SECTOR--PERCEIVED EVIDENCE OF A POSSIBLE LEFTWARD POLITICAL DRIFT IN GOVERNMENT, CONTINUED ABSENCE OF RELIABLE "RULES OF THE GAME" (ONE-MAN GOVERNMENT), AND LACK OF MEANINGFUL DIALOGUE BETWEEN GOVERNMENT AND THE BUSINESS COMMUNITY.

10. THERE ARE QUESTION MARKS OVER TREATY IMPLEMENTATION. HOW ABLY WILL THE GOP MANAGE ITS NEW RESOURCES, EVEN ASSUMING THE ULTIMATE IN US/PANAMANIAN GOODWILL AND COOPERATION IN WHAT IS CERTAIN TO BE A DIFFICULT TRANSITION PROCESS. THE STRAIN ON THE GOP'S MANAGEMENT AND MANPOWER CAPABILITY MAY RESULT IN SERIOUS SNAGS WHICH COULD UNDERMINE CONFIDENCE IN THE GENERALLY HELD EASY ASSUMPTION THAT ECONOMIC BENEFITS TO PANAMA FROM THE TREATIES WILL BE CONSIDERABLE. ACTUALLY, THE DIRECT ECONOMIC BENEFITS ARE LIKELY TO BE QUITE MINOR OTHER THAN THE ESTIMATED \$70 MILLION ANNUAL PAYMENTS TO THE GOP, ACCORDING TO OUR ANALYSIS EARLIER THIS YEAR (SEE PANAMA A-048), SO THAT ANY SIGNIFICANT ECONOMIC BENEFITS BEYOND THESE PAYMENTS WILL HAVE TO COME LIMITED OFFICIAL USE

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ABOUT INDIRECTLY THROUGH PRIVATE INVESTMENT IN ANCILLARY ACTIVITIES.

11. ALSO, THERE IS NO ASSURANCE, OF COURSE, THAT CANAL TRAFFIC WILL HOLD UP OR POSSIBLY EXPAND SLIGHTLY AS CURRENTLY PREDICTED, FOLLOWING THE PLANNED 20-25 PERCENT TOLL BOOST AT THE ONSET OF TREATY IMPLEMENTATION PLUS ANOTHER SIMILAR BOOST ANTICIPATED SOON THEREAFTER. THE TRAFFIC RESPONSE WILL IMPACT DIRECTLY ON PANAMA'S ECONOMY -- E.G., PORT ACTIVITIES SUCH AS SHIP PROVISIONING, REPAIRING, ETC. -- AS WELL AS DIRECTLY AFFECT REVENUE PROCEEDS TO THE GOP.

12. A MAJOR CONSIDERATION FOR PUBLIC SECTOR INVESTMENT OVER THE LONGER PULL IS THE GOP'S FINANCIAL CAPACITY TO SERVICE ITS INCREASINGLY BURDENSOME DEBT, AND TO THEREBY SUSTAIN THE HIGH RATE OF CREDIT FLOW -- MOSTLY FROM ABROAD -- REQUIRED FOR THE GOP'S INVESTMENT PROGRAM. WE FORESEE A CONTINUING PROBLEM FOR THE GOP IN THIS REGARD, AS POINTED OUT IN OUR LATEST ANNUAL GOP DEBT STUDY (PANAMA 3815). THE RECENT \$300 MILLION REFINANCING (SEE PANAMA 5109)

PROVIDES THE GOP ONLY TEMPORARY RELIEF BY REDUCING AMORTIZATION OVER THE NEXT 3-4 YEARS, BUT INCREASING IT FOR THE SUBSEQUENT FIVE YEARS. MOREOVER, 1978 FIRST HALF LOAN DISBURSEMENTS TO THE GOP OF OVER \$500 MILLION (EXCLUDING THE \$300 MILLION REFINANCING) -- MOSTLY FOREIGN SOURCED -- WERE MUCH HIGHER THAN INITIALLY PROJECTED FOR THE ENTIRE YEAR. TAKING THESE LATEST DEVELOPMENTS INTO ACCOUNT, WE NOW PROJECT SERVICING OF PANAMA'S TOTAL PUBLIC SECTOR DEBT TO INCREASE FROM \$335 MILLION IN 1978 TO \$550 MILLION IN LIMITED OFFICIAL USE

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1982 AND RISE FURTHER THEREAFTER WITH NO PEAKING IN SIGHT. FOR THE CENTRAL GOVERNMENT ONLY, THE INCREASE IS FROM AN ESTIMATED \$122 MILLION IN 1978 TO \$346 MILLION IN 1982 -- FROM 33 TO 53 PERCENT OF CURRENT REVENUES. PROJECTED REVENUES INCLUDING \$70 MILLION ANNUAL CANAL PAYMENTS STARTING IN 1980 APPEAR SUFFICIENT TO COVER PROJECTED CURRENT EXPENDITURES OF THE CENTRAL GOVERNMENT INCLUDING ITS INTEREST COSTS, BUT WOULD NOT COVER PROJECTED AMORTIZATION. THUS, THE GOP MAY HAVE TO CURB CURRENT OUTLAYS, CUT BACK ITS INVESTMENT PROGRAM AND/OR ARRANGE A MAJOR DEBT REFINANCING PRIOR TO 1982.

13. IN VIEW OF THE ABOVE, A WIDE RANGE OF ECONOMIC PROJECTIONS OF THE NEXT FIVE TO TEN YEARS IS POSSIBLE, DEPENDING ON WHAT SET OF ASSUMPTIONS ONE USES. HOWEVER, THERE CAN BE NO MEANINGFUL PROJECTION UNTIL THERE IS SOME EVIDENCE ON SUCH KEY DETERMINANTS AS INVESTOR ATTITUDES AND GOP FISCAL PERFORMANCE AND ITS HANDLING OF TREATY IMPLEMENTATION -- WHICH IS NOT LIKELY TO APPEAR FOR ANOTHER YEAR OR TWO. DIKEOS

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## Message Attributes

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